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# Kuwait: Coping With Economic Setbacks

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**An Intelligence Assessment**

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## **Kuwait: Coping With Economic Setbacks**

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**An Intelligence Assessment**

This paper was prepared by [redacted]  
Office of Near East-South Asia Analysis. It was  
coordinated with the National Intelligence  
Council and the Directorate of Operations.  
Comments and queries are welcome and may be  
directed to the Chief, Persian Gulf Division,  
NESA, [redacted]

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**Key Judgments***Information available  
as of 21 March 1983  
was used in this report.*

The Kuwaitis have made little effort to slow spending despite a fall of \$5 billion, or almost 40 percent, in oil income in 1982 and the likelihood of another drop this year. Kuwait is still in a strong financial position and does not want to chance unrest among native Kuwaitis or the majority expatriate population by introducing large spending cuts. The leadership is especially sensitive to popular opinion after having spent some \$2 billion to support financial institutions following the collapse of Kuwait's unofficial stock market in August 1982. If oil prices do not collapse, the government is likely to spend billions of dollars more to bail out market investors.

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Kuwait also will continue to fund capital projects it considers essential to long-range development. Most importantly, the Kuwait Petroleum Corporation, the state oil company, will pursue its plan to establish a fully integrated, international oil company that would ensure secure markets for its oil. KPC recently has added Gulf Oil's operations in the Benelux countries, Denmark, and Sweden to its long list of foreign acquisitions and plans further expansion in Western Europe, the United States, and Japan.

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As a staunch supporter of the Arab cause against Israel, Kuwait will not let lower revenue slow its Baghdad Summit payments to the confrontation states of Jordan and Syria. Kuwait also will help finance Iraq's war against Iran to prevent the spread of Tehran's brand of Islam.

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Kuwait's large foreign exchange reserves and the income from these assets will enable it to proceed with its plans despite some financial problems. Investment income this year will nearly equal oil earnings for the first time. The regime probably will liquidate longer term reserves, such as dollar-denominated bonds, to meet its financial obligations if necessary. It, however, is unlikely to draw down its large equity holdings because it views these as its major source of income when oil reserves are exhausted.

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Only an oil price collapse probably would compel Kuwait to slash spending on development projects, foreign aid, acquisitions, and subsidies. Under these circumstances, stock market investors also would find the government much less generous.

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The United States—second to Japan in exports to Kuwait—will probably lose sales if Kuwait reduces spending. US-Kuwaiti political relations, however, are unlikely to be much affected by Kuwait's economic problems. Kuwait will remain suspicious of US intentions in the Gulf and will resent what it sees as US unwillingness to stand up to the Israelis. As for oil policy, the Kuwaitis' recent market experience should make them less willing to push up oil prices rapidly when the market is strong.

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## Kuwait: Coping With Economic Setbacks

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Kuwait deliberately slowed oil production and exports during 1980-81—even more than required by the weakening oil market—to extend the life of its oil reserves. Still, the government had sufficient revenues to subsidize the needs of its small population, accelerate investment spending, and continue adding to its financial reserves. Investment expenditures were allocated to establish secure markets for its oil abroad and to generate new sources of income. The latter strategy has been particularly successful, and, as a result, the sharp drop in demand for Kuwaiti oil over the last year is unlikely to change significantly the ways the government spends its money. It can count on foreign investment income as well as reserves to help sustain spending programs. To ensure future revenues, Kuwait also created a special reserve fund in 1976 that cannot be drawn on until the next century. Meanwhile, rapidly rising incomes have led to rampant speculation by Kuwaitis and foreigners in domestic stocks and real estate.

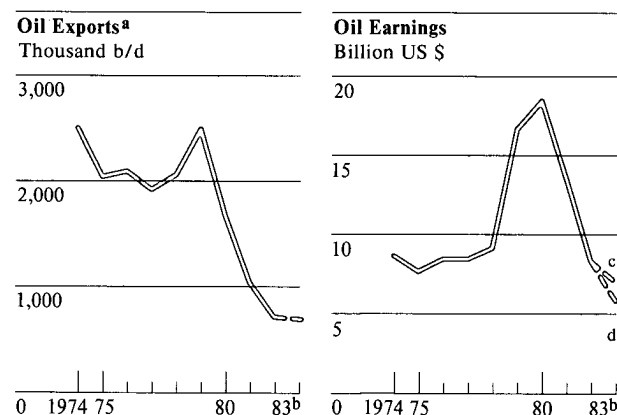
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### Revenues

**Recent Trends.** Kuwaiti oil revenues, which account for 80 percent of export sales, fell to \$8.4 billion in 1982, less than half the peak level in 1980. Exports of crude oil and products averaged about 700,000 barrels per day in 1982, only about one-third the level of the 1970s. To sell even this quantity of oil in 1982, Kuwait was forced to cut its price at the beginning of the year to match the OPEC realignment of the benchmark; the average selling price in 1982 was \$32.30 per barrel, about \$3 per barrel less than in 1981. Several crude oil customers, including Italy's ENI, Shell, British Petroleum, and Gulf Oil negotiated for reduced liftings or canceled contracts altogether because of price disputes.

Refined product exports, which make up about two-thirds of Kuwait's petroleum sales abroad, also are facing stiffer competition. Kuwait is now selling most of its products in the Far East, one of the few markets where it can still compete. But with Caribbean refineries underselling Kuwait in several product lines, Japanese companies told Kuwait they will switch to

**Figure 1**  
**Kuwait: Oil Exports and Earnings**



<sup>a</sup> Including products, natural gas liquids, and Kuwait's share of Neutral Zone production.

<sup>b</sup> Estimated.

<sup>c</sup> At an average of \$28 per barrel for the year assuming the new \$27 per barrel price is in effect for March-December.

<sup>d</sup> At an average of \$23 per barrel for the year assuming prices decline further later this year.

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the Caribbean if Kuwait does not lower its price. The Japanese are now Kuwait's only long-term products customer.

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The fall in oil revenues was partly offset by income from official assets invested abroad. This income amounted to \$7.6 billion in 1982, up over 40 percent from 1980. Kuwait's foreign asset holdings—which totaled roughly \$70 billion at the end of 1982—include an assortment of stocks, bonds, and real estate

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Figure 2



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**Table 1**  
**Kuwait: Current Account 1974-82**

Billion US \$

	1974	1975	1976	1977	1978	1979	1980	1981	1982
<b>Exports (f.o.b.)</b>	<b>9.1</b>	<b>8.3</b>	<b>9.3</b>	<b>9.3</b>	<b>10.0</b>	<b>17.8</b>	<b>20.0</b>	<b>15.4</b>	<b>10.5</b>
Oil	8.7	7.7	8.5	8.5	9.2	16.7	18.5	13.3	8.4
Nonoil	.4	.6	.7	.8	.8	1.1	1.5	2.1	2.1
<b>Imports (f.o.b.)</b>	<b>-1.6</b>	<b>-2.4</b>	<b>-3.3</b>	<b>-4.7</b>	<b>-4.3</b>	<b>-4.9</b>	<b>-6.8</b>	<b>-7.1</b>	<b>-7.5</b>
Trade balance	7.5	5.9	6.0	4.6	5.7	13.0	13.2	8.3	3.0
<b>Net services and private transfers</b>	<b>.3</b>	<b>.1</b>	<b>.2</b>	<b>.1</b>	<b>.4</b>	<b>1.9</b>	<b>2.7</b>	<b>4.9</b>	<b>4.9</b>
Freight and insurance	-.2	-.3	-.4	-.7	-.6	-.6	-1.0	-1.1	-1.0
Investment income receipts	.8	.7	1.0	1.4	2.0	3.5	5.3	7.4	7.6
Other	-.3	-.3	-.3	-.5	-1.0	-1.0	-1.6	-1.4	-1.7
<b>Grants</b>	<b>-1.5</b>	<b>-.8</b>	<b>-.2</b>	<b>-.9</b>	<b>-.8</b>	<b>-.8</b>	<b>-.9</b>	<b>-.9</b>	<b>-1.0</b>
Current account balance	6.3	5.2	6.0	3.8	5.3	14.1	15.0	12.3	6.9

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25X1 holdings. Its equity investments are mainly in the United States; the major US asset is Santa Fe International, a \$2.5 billion diversified petroleum company owned by the Kuwait Petroleum Corporation (KPC), the state oil company. [REDACTED]

25X1 The government does not have all its oil revenues available for discretionary use. By law, the government is required to deposit 10 percent of all revenues, excluding investment income, in the Reserve Fund for Future Generations, where it must remain until 2001. [REDACTED]

25X1 **Near-Term Outlook.** If crude prices average \$28 per barrel for Kuwaiti crude in 1983—assuming Kuwait is able to hold its official price at \$27 per barrel through the end of the year—oil revenues will fall to about \$7.1 billion, a 15-percent drop from the 1982 level. We believe demand for OPEC oil is likely to average 18 million barrels per day in 1983, with Kuwait's share some 700,000 barrels per day, including products. Kuwait, along with other OPEC producers, has agreed to cut prices about \$5 per barrel. Even in the unlikely event Kuwait reaches its oil export goal of 1 million barrels per day—equivalent to more than its quota under the new OPEC production ceiling—revenues would still be well below recent levels. [REDACTED]

KPC probably will not be able to increase oil exports much as a result of the recent price drop as customers delay purchases in anticipation of a further reduction. Japanese traders have notified KPC they will wait until the market settles before they decide to negotiate long-term contracts. Despite the lower price, the Chinese Petroleum Company, Kuwait's largest crude customer, did not increase purchases from the earlier level of about 75,000 barrels per day in the new contract it signed last March. [REDACTED] 25X1

An oil price war could substantially lower Kuwait's oil revenue. If Kuwait were forced to drop its official price later this year, so that the price in 1983 averaged \$23 per barrel for example, earnings would fall to less than \$6 billion, even if exports picked up somewhat. Kuwait could not make up a crude oil price cut with increased product exports in the near term because product outflow already is near refinery capacity. Expanded domestic refinery capacity will not be ready until at least 1984, and KPC probably will need about a year to upgrade its refineries overseas. [REDACTED] 25X1

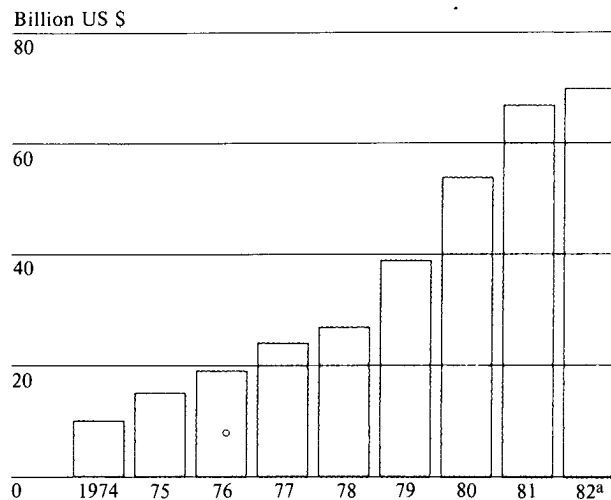
Investment income will provide Kuwait with a substantial foreign exchange cushion to offset the projected loss in oil revenue. Although we estimate income

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**Figure 3**  
**Kuwait: Official Foreign Assets**

<sup>a</sup> Estimated.

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from official assets will fall about \$900 million from last year, largely because of lower interest rates in the West, this income is likely to approach oil revenues. Until now, Kuwait has used investment income to build its asset holdings.

#### Spending

**Recent Trends.** Kuwait is using depressed oil revenues as an opportunity to slow its social programs, to concentrate on more productive investments, and to trim waste. Expenditures in fiscal year 1983, which ends on 30 June, were slated to increase by only 7 percent over FY 1982—to about \$11.7 billion—in contrast with growth rates of up to 25 percent in previous years. In real terms, this translates into a planned decline in spending in FY 1983.

Most of the spending slowdown is in subsidies and operating expenses, which make up close to two-thirds of total spending. The Kuwaitis lowered domestic subsidies on petroleum products by about \$315 million, according to the US Embassy in Kuwait, causing retail prices of oil to triple. Kuwait, however, still

**Table 2**  
**Kuwait: Government Finances 1979-82**

Billion US \$

	1979 <sup>a</sup>	1980	1981	1982
<b>Official budget</b>				
Revenues	11.2	21.8	15.9	10.4
Oil	10.9	21.4	15.5	9.6
Nonoil	0.3	0.4	0.4	0.8
Actual expenditures	5.9	7.9	9.3	10.3
RFFG	1.2	2.2	1.6	1.0
Official balance	4.1	11.7	5.0	-0.9
<b>Nonbudgeted</b>				
Investment income	1.9	3.2	6.3	7.4 <sup>b</sup>
Expenditures			3.0 <sup>c</sup>	3.0 <sup>c</sup>
Aid to Iraq			3.0 <sup>c</sup>	3.0 <sup>c</sup>
Nonofficial Balance	6.0	14.9	8.3	3.5

<sup>a</sup> Fiscal year begins 1 July and ends 30 June for the year indicated.<sup>b</sup> Preliminary.<sup>c</sup> Estimated.

provides the equivalent of roughly \$3,500 per person in direct and indirect subsidies annually, including over 90 percent of electricity and water costs. To reduce operating expenses, the government implemented a hiring freeze on non-Kuwaiti employment in the public sector and called on ministries to reduce their work force by 10 percent.

Expenditures for capital development projects, which make up nearly 20 percent of total spending, will be largely unaffected. Indeed these outlays will account for all the planned increase in expenditures in FY 1983. Capital spending typically has concentrated on electric, water, and other public works projects but also includes land acquisition and housing. The recent drop in oil prices is unlikely to force Kuwait to cut development spending substantially.

Kuwait has spent at least \$6 billion since last October to restore business confidence following the collapse of Kuwait's unofficial stock market, the Souk Al Manakh. The government has purchased shares on the

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**Table 3**  
**Kuwait: Budget Versus Actual Outlays**

Billion US \$

	1979 <sup>a</sup>	1980	1981	1982	1983
<b>Current expenditures <sup>b</sup></b>					
Budget	3.8	5.0	7.1	7.8	7.8
Actual	3.7	5.2	6.1	6.6	NA
Overspending (underspending)	(0.1)	0.2	(1.0)	(1.2)	NA
<b>Development expenditures</b>					
Budget	2.9	3.6	3.4	3.1	3.9
Projects	2.5	2.4	2.7	2.0	2.9
Land acquisition	0.4	1.2	0.7	1.1	1.0
Actual	2.2	2.7	3.2	3.7	NA
Projects	1.8	1.7	1.8	2.1	NA
Land acquisition	0.4	1.0	1.4	1.6	NA
Overspending (underspending)	(0.7)	(0.9)	(0.2)	0.6	NA
<b>Total <sup>c</sup></b>					
Budget	6.7	8.6	10.5	10.9	11.7
Actual	5.9	7.9	9.3	10.3	10.5-11.7 <sup>d</sup>
Overspending (underspending)	(0.8)	(0.7)	(1.2)	(0.6)	NA

<sup>a</sup> Fiscal year begins 1 July and ends 30 June for the year indicated.

<sup>b</sup> Includes wages, salaries, subsidies, and foreign grants.

<sup>c</sup> Does not include mandatory payments to the RFFG or changes in the State General Reserves.

<sup>d</sup> Projected.

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official stock exchange and deposited additional funds in banks for loans to insolvent traders unable to cover their debts, according to the US Embassy. Most Kuwaiti financial institutions were left heavily exposed by the crisis, and private capital outflows accelerated. [REDACTED]

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Following the crash, consumer spending slumped, credit demand for new ventures slowed, and commercial debts increasingly were not repaid. Public criticism of the regime grew as several members of the ruling family were accused of failing to intervene in time to prevent the crash because of their personal involvement. [REDACTED]

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The KPC, whose independent budget is larger than that of the central government, is using its income from oil sales to pursue its own investment strategy.

KPC is seeking to establish a fully integrated, international state oil company capable of marketing 1 million barrels per day within three to four years, according to Oil Minister Ali al-Khalifa Al Sabah. Based on press accounts, KPC has spent roughly \$4-5 billion on foreign assets since it was established in 1980. Last year KPC acquired about one-fifth equity share in Hoechst, West Germany's largest chemical concern; a 15-percent share in Promet, a Far Eastern oil rig and construction group; and ownership of Andover, a US oil exploration firm. These and other subsidiaries also give Kuwait petroleum interests in several African countries, Turkey, and China.

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**Stock Market—No Quick Solutions**

*The collapse last summer of the Souk Al Manakh, Kuwait's unofficial stock market,<sup>a</sup> was precipitated when falling prices left increasing numbers of traders unable to cover postdated checks. These checks, totaling over \$90 billion or almost 15 times the currency in circulation, were issued to purchase stocks during the preceding price boom. Most of the checks came due for payment not long after the government had begun to brake the economy.*

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*The government suspended future dealings in the postdated checks and created a clearinghouse to register the checks and determine individual net obligations. It has also proposed a scheme for bailing out investors once the checks are sorted out.*

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*The latest proposals, signed into law last April, include an extension of the maturity date for postdated checks to 31 December 1983, prohibition of insolvent traders from declaring bankruptcy, and the creation of a trust fund, consisting of confiscated assets, to pay creditors with government bonds. Small investors will not be affected and will continue to receive payments from a Small Investors Fund. Meanwhile, the government has frozen the assets of the largest traders.*

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*Despite the new law, Kuwait is apparently not much closer to resolving the situation than it was when the*

*market collapsed. Preoccupied with the new budget and the approach of the holidays, the government is unlikely to implement the law before September. The government also probably will be unwilling to bring to task influential investors, including a member of the National Assembly.*

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*Over two-thirds of the postdated checks apparently are held by eight major traders. Allowing the major traders to declare bankruptcy could trigger failures throughout the financial community. Once the net position is determined, outstanding claims to all traders could total at least \$20 billion, according to the US Embassy. Many traders believe the government's proposals to deal with the checks probably will undergo further major revisions to accommodate different interest groups.*

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*The unresolved crisis will be a further drag on the economy. Kuwaiti bankers are reluctant to lend to investors until their net worth is determined. Moreover, should debtors be forced to sell their property, the already depressed real estate market could collapse as well. The use of postdated checks has also been prevalent in this market.*

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<sup>a</sup> Kuwait's official stock market allows listing only by Kuwaiti companies; the Souk Al Manakh is open to non-Kuwaiti as well as Kuwaiti firms that in some cases were merely paper companies set up for trading in the Souk Al Manakh.

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*In January the KPC acquired Gulf Oil's refining and marketing operations in the Benelux countries, including a 75,000-barrel-per-day refinery, an oil terminal, and a storage area. The deal also provides Kuwait a retail outlet for 80,000 barrels per day of oil, an average of about 6 percent of the market in these countries. In addition, Kuwait has acquired Gulf's facilities in Sweden and Denmark, including an 80,000-barrel-per-day Danish refinery. Kuwait is delivering oil to Gulf to pay for these purchases, which cost an estimated \$600-700 million.*

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*Kuwaiti foreign aid in 1982 totaled roughly \$4 billion. About half of this went to Iraq to support its war effort against Iran. Syria and Jordan received about*

*\$500 million as part of Kuwait's contribution to "frontline" states opposing Israel as called for under the Baghdad Summit Agreement of 1978. The remainder went mainly through the Kuwait Fund for Arab Economic Development (KFAED) to other mainly Islamic LDCs, especially Tunisia, Egypt, Sudan, and Morocco.*

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**Spending Outlook and Implications.** Despite the bleak revenue outlook, the leadership so far does not intend to pursue substantial across-the-board cuts in the FY 1984 budget. In the absence of a price

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collapse, we believe Kuwait probably will use foreign reserves to ensure funding for projects it deems essential to long-range development goals and to avoid large cuts elsewhere. Moreover, the continued costs of dealing with the fallout of the stock market collapse will remain substantial. In our judgment any budget trimming the leadership does impose is likely to continue to focus on operating expenses and, to a lesser extent, subsidies. An oil price collapse would probably encourage the Kuwaiti leadership to be less generous to stock market investors and to slow capital development projects. [redacted]

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**Capital Spending.** Government capital project spending is unlikely to be cut; it may even be increased. The government is considering allocating as much as \$3.4 billion for "essential" capital projects in FY 1984, according to a US Embassy source. This compares with the FY 1983 budget level of \$2.9 billion and actual outlays of \$2.1 billion in FY 1982. New project spending will concentrate on power generation, water desalination, housing, roads, and telecommunications. If oil prices collapse, the regime probably will stretch out construction on nonessential projects such as a major waterfront beautification scheme and relocation of the national university. [redacted]

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Kuwait probably will be able to realize small savings in foreign worker remittances as some projects under way are postponed or completed. Anticipating this slowdown in nonessential construction, Kuwait already has sent 50,000 Indian workers home, according to the press. The hiring freeze and progressive restrictions on foreign entry will provide some additional help. Kuwaiti leaders know, however, that wholesale layoffs would harm the economy since the country depends heavily on foreign workers. Moreover, Kuwait would create serious political problems by deporting large numbers of these expatriates. [redacted]

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**KPC Spending.** KPC has budgeted \$1.75 billion for development spending during the coming fiscal year, according to the Oil Minister. Although it probably will not turn a profit from its oil sales this year, it has sufficient capital to pursue its overseas goals. Eventually KPC plans to refine 20 percent of its crude oil overseas, with Western Europe as the hub of its petroleum distribution network, according to the Oil Minister. [redacted]

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KPC will also pursue its ambitious efforts to purchase overseas distribution systems, according to the chairman of the Kuwait Oil Tanker Company. It expects to begin negotiations soon for Gulf's facilities in the UK that are valued at about \$1 billion, according to the press. KPC also made approaches to Elf-Aquitaine and Chevron; the latter has offered to discuss a 50-50 joint venture with KPC. After Western Europe, Kuwait plans to turn to Japan and then the United States. According to the Oil Minister, Kuwait has no concrete marketing strategy for either country, but it is considering investment on the US east coast, perhaps in two years. [redacted]

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KPC has decided to invest in only those domestic refinery and petrochemical projects where a 20-percent rate of return seems likely. As a result, it has postponed:

- Construction of a \$1.3 billion petrochemical complex.
  - A \$3.5 billion expansion and modernization of the Mina Abd Allah Refinery that would have raised total capacity to about 750,000 barrels per day.
- KPC officials believe they can upgrade the recently acquired Rotterdam refinery for less than \$2 billion and still meet their needs. The purchase of Hoechst probably helped undermine the petrochemical project. [redacted]

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Meanwhile, KPC last March awarded a contract for the construction of the \$200 million Southern Gas Project to a French firm. Scheduled for completion in 1985, the project will help make up a shortage of natural gas in Kuwait. Current crude oil production does not provide nearly enough byproduct gas to meet Kuwait's domestic requirements. [redacted]

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KPC this year has ordered a 10-percent across-the-board cut in expenditures on top of a hiring freeze last year. In addition, the KPC intends to reduce its staff 10 percent every year until FY 1986. [redacted]

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**Subsidies.** The leadership is considering further reducing consumer subsidies, but for political reasons it is unlikely to cut enough to realize significant savings. Proposals to lower subsidies and services further are

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already drawing fire from several quarters, according to the US Embassy. The regime fears alienating not only the Kuwaitis, but the large, disparate, and potentially volatile expatriate population. Foreigners number about 900,000—50 percent more than the native Kuwaitis—according to the government's 1982 estimate. Kuwait so far has used subsidies and job opportunities to placate the Palestinian community. The Palestinians, who make up the largest foreign presence, however, are chafing at Kuwait's property and citizenship regulations as well as at social discrimination. [redacted]

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The government is more likely to reduce electricity and water payments because this would help slow soaring consumption, which is straining available capacity. Other subsidies, including housing, food, and hospitalization, would be threatened if oil prices were to fall precipitately. [redacted]

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**Stock Market.** The regime may spend at least an additional \$2.8-3.5 billion to rescue investors over the next year, according to Kuwaiti financial officials. It wants to head off bankruptcy declarations by both large and small traders. The government, however, has stopped purchasing all but small blocks of shares at selected support prices, at least for the time being; an oil price collapse would encourage the leadership to be less generous to investors. [redacted]

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**Foreign Aid.** For political and strategic reasons, Kuwait probably will choose not to make substantial reductions in its foreign aid program unless oil prices decline sharply. It may even increase its aid if it decides to make reconstruction payments to Lebanon and reparations to Iran—on Iraq's behalf—after the Iraq-Iran war. Many recipients, however, are likely to find it more difficult to obtain funds on schedule. [redacted]

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Kuwait is likely to continue substantial aid to Iraq in our view. It does not want Iran's revolution exported, nor does it want to antagonize Baghdad. Kuwait already has given Baghdad an additional \$300 million this year and may attempt to sell oil on Iraq's behalf, a move that would be cheaper than making direct cash payments since Kuwait's actual outlay would only be the cost of producing the oil. [redacted]

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To preserve Arab solidarity against Israel, Kuwait probably will continue to give top priority to its payments to the confrontation states under the Baghdad Summit Agreement. This year Kuwait is scheduled to provide about \$525 million to Syria, Jordan, and the PLO. Because of cash shortages, however, Kuwait is unlikely to make up arrearages for Libya and Algeria as it has in the past and will no longer pay its \$23 million share to the PLO-Jordanian Joint Committee. [redacted]

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Non-Arab countries that seek money from institutions such as the KFAED will find Kuwaiti purse strings drawn tighter. Kuwait earlier this year turned down a request from Yugoslavia for \$300 million. But Kuwait sees the KFAED as an important tool for enhancing its international reputation. [redacted]

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**Imports.** The slowdown in overall spending probably will be enough to hold imports in 1983 close to last year's \$7.5 billion, compared with the 18-percent average annual growth rate from 1978-82. Kuwait is not likely to risk popular dissatisfaction by substantial cuts in consumer imports unless oil prices drop more sharply. Roughly 40 percent of Kuwait's imports ultimately are consumer oriented. [redacted]

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Imports could decline from last year's level if Kuwait decides to devalue the dinar this year. Despite a public denial by Finance and Planning Minister al-Hamad, Kuwait banking officials believe that Kuwait's economic problems make a devaluation inevitable. By the end of 1983 the value of the dinar could fall to perhaps \$2.86 compared with the current rate of about \$3.46. [redacted]

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#### **Balance-of-Payments Outlook**

The expected decline in oil revenues will further shrink Kuwait's current account surplus in 1983. If Kuwait sustains its oil price at \$27 per barrel for the remainder of the year so that the annual price averages \$28, if oil exports average about 700,000 barrels per day, and if imports approximate last year's level, Kuwait would have a current account surplus of

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**Table 4**  
**Kuwait: Balance-of-Payments**  
**Scenarios, 1983**

Billion US \$

	Case A	Case B
Trade balance	1.1	-0.1
Exports (f.o.b.)	9.1	7.9
Oil	7.1	5.9
Nonoil	2.0	2.0
Imports (f.o.b.)	-8.0	-8.0
Net services and transfers	3.7	3.7
Investment income <sup>a</sup>	6.7	6.7
Freight and insurance	-1.1	-1.1
Other	-1.9	-1.9
Grants	-1.0	-1.0
Current account balance	3.8	2.6
Capital outflows <sup>b</sup>	-4.5	-4.0
Aid to Iraq	-2.0	-2.0
Other	-2.5	-2.0
Changes in official foreign exchange reserves	-0.7	-1.4

Assumptions	Case A	Case B
Oil exports (thousand b/d)	700	700
Oil price average for year <sup>a</sup> (US \$ per barrel)	28	23

<sup>a</sup> Earnings on government foreign assets only.<sup>b</sup> Official outflows only.

to Iraq—have probably amounted to several billion dollars annually in recent years and probably will exceed the current account surplus this year. Moreover, our projection for oil income at \$28 per barrel for the year indicates that Kuwait would have to place at least \$600-700 million in the RFFG, further limiting its flexibility to manage its assets.

If pressed, Kuwait probably would cash in its fixed interest bonds first—about 20 percent of its reserves—partly because they are more easily converted into money. The regime would sell equity assets from its reserves only as a last resort since it views these as its major income resource when the oil wells run dry.

### Budget Outlook

The official budget this fiscal year will be in deficit—by about \$4 billion—for the first time in nearly 10 years. This deficit is misleading, however, because Kuwait does not include investment earnings in the official budget, in part, according to the chairman of the National Assembly Committee on Finance, because it provides Kuwait an excuse to turn away aid requests. Although investment income will more than offset this nominal budget deficit, it probably will not cover aid to Iraq and funds to bail out stock market investors.

Even allowing for a 10-percent cut in budget expenditures in FY 1984, Kuwait would run a deficit of about \$3 billion. This could be offset by investment income, but if Kuwait is still saddled with payments to stock market investors and Iraq, the government probably will have to draw down reserves again to cover the budget shortfall.

### Implications for the United States

We anticipate little change in US-Kuwaiti economic relations. US oil purchases from Kuwait are negligible, and we believe US exports to Kuwait in 1983 probably will approximate last year's level of roughly \$1 billion. Kuwait's declining oil revenues coupled with a strong US dollar are likely to prevent the United States this year from increasing its market share in Kuwait, now second only to that of Japan.

about \$3.8 billion. This compares with surpluses of about \$7 billion in 1982 and over \$12 billion in 1981. If a price war were to develop and Kuwait's official price fell to an average of \$23 per barrel for the year, the 1983 current account surplus would be \$2.6 billion, assuming Kuwait's market share remained unchanged.

The decline in Kuwait's traditionally large investable surplus probably will force it to change the composition of its asset portfolio. Kuwait probably will have to liquidate some of its longer term reserve assets this year to provide the foreign exchange for priority capital and aid outflows. These capital outflows—including KPC and private investments as well as aid

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**Table 5**  
**Kuwait: Budget Scenarios**

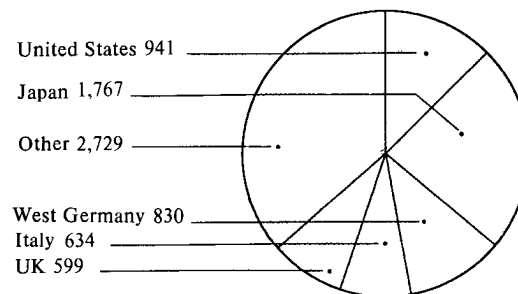
Billion US \$

	FY 1983 <sup>a</sup> FY 1984 <sup>a</sup>		
	Case A	Case A	Case B
<b>Official budget entries</b>			
Revenues	8.8	8.4	6.1
Oil income	7.5	6.9	4.6
Taxes, customs duties, and others	1.3	1.5	1.5
Expenditures	11.7	10.5	10.5
RFFG	0.8	0.6	0.4
Official balance	-3.7	-2.7	-4.8
<b>Nonbudget items</b>			
Investment income	7.1	7-8	7-8
Expenditures	8.0	4-6	4-6
Aid to Iraq	2.0	2.0	2.0
Stock market assistance	6.0	2-4	2-4
Nonofficial balance	-4.8	0.3-0.7	-1.8-2.8
<b>Assumptions</b>			
Oil exports (thousand b/d)	700	700	700
Oil price (US \$ per barrel)	27 <sup>b</sup>	27 <sup>c</sup>	18 <sup>d</sup>

<sup>a</sup> Fiscal year ends in June of the year indicated.<sup>b</sup> Reflects \$32 per barrel price in July 1982-February 1983, and \$27 per barrel March-June 1983.<sup>c</sup> Assumes Kuwait's official price of \$27 per barrel holds for FY 1984.<sup>d</sup> Assumes price break by late calendar 1983.**Figure 4****Kuwait: Imports (FOB) by Country of Origin, 1982**

Million US \$

Total=7,500



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Kuwait probably will not want to strengthen its political ties with the United States. It is protective of its nonaligned status and distrusts US intentions in the region. Relations will also depend on US policy toward the Arab-Israeli issue. Kuwait is an ardent supporter of the Palestinians, in part because of its own large Palestinian population.

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Kuwait is not likely to push again for rapid oil price increases when the market firms. We believe Kuwait now recognizes that its short-term gains had significant long-term costs. Moreover, expanding Kuwaiti investments in US and West European downstream petroleum facilities are also likely to make Kuwait more considerate of Western concerns about OPEC oil pricing policy.

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The Kuwaitis, who generally select the lowest contract bid, will be even more price sensitive. US export mainstays of machinery, semifinished goods, and automobiles will face increasing competition, especially from Japan. US oil service firms may lose business as Kuwait turns to foreign subsidiaries.

The pace of Kuwaiti investment in the United States probably will slow, but Kuwait is not likely to significantly reduce investments in US dollar-denominated securities. In our judgment Kuwait sees these securities, which now account for over two-thirds of its foreign assets, as a financially secure haven for its reserves.

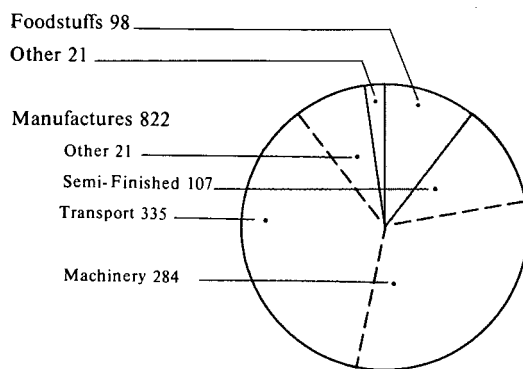
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**Figure 5**  
**Kuwait: Composition of US Imports, 1982**

Million US \$

Total=941



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